Beware the Market Rally: The TSX Could Plunge From Here

Description

Investors should be cautious of the recent 30% market rally on the TSX. While progress against the coronavirus is slowly being made, the Canadian economy remains in a fragile state. Markets have rallied at any hint of good news (i.e., a drop in COVID-19 infection rates), and yet they somehow have seemed to ignore any of the bad news. At the start of April, Canada's jobless claims jumped to over two million, yet the TSX still rallied some 1,000 points.

This market rally doesn't make sense

This was made more vivid yesterday, when the Western Canadian Select oil spot price dipped below zero. The response on the TSX: it went up a comfy 20 basis points. While only 10% of Canada's GDP is directly related to energy production, that is essentially 10% of GDP that just went out the window yesterday. The TSX hardly batted an eye!

It is not just the 10% that is concerning. It is Canada's service economy: the hotels, the freight companies, the shuttered retailers, the Tim Hortons in every small town, and the list goes on. The only things holding up the TSX right now are a major amount of government subsidies, central bank stimulus, and the recent fast run into **Shopify**.

Be cautious of the recent market rally

Now you may think that I am market bear. I am not. I believe that Canada and the TSX is a great place to invest for the next 10 to 20 years. There are some phenomenal stocks that are worthy of your investment. All I am saying is TSX investors ought to be very cautious about this particular market rally.

There are significant short-term economic risks that could easily translate into very long-term economic risks (i.e., increasing personal and corporate bankruptcies). There is still a lot of bad economic and corporate data we have to work through. The market rally is here, but I am skeptical it will survive past spring.

Don’t spend all your free capital on the market rally

Now that you got past my cold dose of pessimism, I want to talk about a few of those “phenomenal” TSX stocks to keep on your radar. This market rally is a really bad reason to deploy all your free capital. Instead, take this moment to draw up your wish list. Then slowly and methodically chip away at it for the rest of the year. Make sure to only invest what you can afford to lose or to have tied up for a long period.

Below are a few stock ideas for you to consider.

Alternative assets

The first that I believe is essential to every Canadian’s portfolio is **Brookfield Asset Management**. This is one of the best-run companies in Canada and maybe even the world. It has a very counter-cyclical approach to investing. I think a recession could play out very well for them over the long term.

The company has a robust balance sheet and is sitting on about $30 billion of investable capital. Alongside Oaktree Capital, Brookfield will have substantial opportunities to benefit from distressed asset, debt, and stock sales. I think this stock will rally quickly when the market and economy normalize.

Software as a service

The second stock is **Enghouse Systems** (TSX:ENGH). This stock has risen an enormous 44% with the recent market rally. I would say the stock is a bit pricey right now. However, it is a good buy on any drop. First, the company is equipped to prosper in a social-distancing scenario. Its diverse suite of software-as-a-service (SAAS) business solutions are helping businesses manage everything from inventory to network to customer interactions. In a stay-at-home economy, Enghouse’s products are more needed than ever.

Second, the company has been an active acquirer of diverse SAAS businesses. Right now, it is sitting on $150 million of cash. I suspect a recession will allow it to slowly deploy that capital into some great discounted opportunities. The company is conservatively managed and has grown rapidly over the past few years. Any dip is a great chance to buy into this highquality name.

Be wise, be cautious, and stay Foolish!

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Date
2025/07/05
Date Created
2020/04/21
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